

Managed Funds Association

The Voice of the Global Alternative Investment Industry

Washington, D.C. | New York



April 18, 2022

Via Electronic Submission: rule-comments@sec.gov

Ms. Vanessa Countryman
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: File No. S7-02-22; Amendments to Exchange Act Rule 3b-16 Regarding the Definition of “Exchange”; Regulation ATS for ATSS That Trade U.S. Government Securities, NMS Stocks, and Other Securities; Regulation SCI for ATSS That Trade U.S. Treasury Securities and Agency Securities

Dear Ms. Countryman:

Managed Funds Association (“MFA”)¹ welcomes the opportunity to comment on the Securities and Exchange Commission’s (“Commission” or “SEC”) proposal (“Proposal”)² to amend Rule 3b-16 and Regulation ATS under the Securities Exchange Act of 1934 (“Exchange Act”).

I. Executive Summary

MFA continues to support the effective regulation of critical market infrastructure and trading venues. As such, we support the Commission’s proposed amendments to increase

¹ MFA represents the global alternative investment industry and its investors by advocating for sound industry practices, regulatory, tax and other public policies that foster efficient, transparent and fair capital markets. MFA’s more than 150 member firms collectively manage nearly \$1.6 trillion across a diverse group of investment strategies. MFA is an advocacy, education, and communications organization established to enable investment advisers in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry’s contributions to the global economy. MFA has a global presence and is active in Washington, D.C., London, Brussels, and Asia.

² Amendments Regarding the Definition of “Exchange” and Alternative Trading Systems (ATSS) That Trade U.S. Treasury and Agency Securities, National Market System (NMS) Stocks, and Other Securities, 87 Fed. Reg. 15496 (Mar. 18, 2022) (“Proposing Release”), available at: <https://www.govinfo.gov/content/pkg/FR-2022-03-18/pdf/2022-01975.pdf>. The Proposal includes reproposals of certain amendments included in the Commission’s 2020 proposed amendments to Regulation ATS. See Regulation ATS for ATSS That Trade U.S. Government Securities, NMS Stock, and Other Securities; Regulation SCI for ATSS That Trade U.S. Treasury Securities and Agency Securities; and Electronic Corporate Bond and Municipal Securities Markets, 85 Fed. Reg. 87106 (Dec. 31, 2020) (“2020 Proposal”), available at: <https://www.govinfo.gov/content/pkg/FR-2020-12-31/pdf/2020-21781.pdf>.

operational transparency, system integrity, and regulatory oversight of alternative trading systems (“ATs”) that trade government securities, as defined under Section 3(a)(42) of the Exchange Act, or repurchase and reverse repurchase agreements on government securities (“Government Securities ATs”) by eliminating the current exemption from Regulation ATS for Government Securities ATs. Furthermore, we support applying the fair access requirements of Regulation ATS to Government Securities ATs as described in the Proposal and supports requiring Government Securities ATs exceeding certain volume thresholds to meet the requirements of Regulation SCI. We believe these amendments to Regulation ATS and Regulation SCI will advance investor protection and benefit the market for government securities in numerous ways.

MFA does not, however, support the proposed changes to Rule 3b-16 as set forth in the Proposal. We believe that the Commission’s proposed changes to Rule 3b-16 would, if adopted as proposed, represent a significant reconceptualization of key features of the broader securities market’s structures and could inappropriately capture a number of systems within the definition of “exchange” and subject those systems to significant regulation as “exchanges” or ATs that is not warranted. Because of the significant impact this aspect of the Proposal could have on market structure, we strongly encourage the Commission to consider the comments it receives and to publish a subsequent proposal to amend Rule 3b-16 before moving forward with changes to the definition of “exchange.”

II. Background & Overview

MFA believes in the importance of ensuring the effective regulation of critical market infrastructure and trading venues, as well as the robust disclosure and transparency of information to investors about the operations of such infrastructure and venues.³ We are pleased that the Proposal seeks to address prior MFA concerns on the need for increased operational transparency, system integrity, and regulatory oversight of ATs and, specifically, to extend Regulation ATS to Government Securities ATs. MFA supports the Commission’s proposal to adopt measures to eliminate the government securities exemption from Regulation ATS.

In a previous letter to the Commission, MFA urged the Commission to examine other electronic trading venues that operate in the government securities markets and the fixed income markets overall, noting that certain trading venues that utilize request-for-quote (“RFQ”) or streaming quote protocols in the cash Treasury market resemble multiple-to-multiple markets and have significant volume traded on them.⁴ In this letter, we urged the Commission to consider how similarly situated entities might be treated in a more similar manner to improve the

³ See Letter from Jennifer W. Han, Chief Counsel and Head of Regulatory Affairs, MFA, to Vanessa Countryman, Secretary, SEC, on March 1, 2021 (“2021 Letter”), available at: <https://www.sec.gov/comments/s7-12-20/s71220-8431832-229618.pdf>, at 1.

⁴ See *id.* at 1-2.

efficiency and resiliency of trading in government securities, although we cautioned that electronic trading systems broadly should not be captured as ATSS.⁵

In our view, however, the proposed changes to the definition of “exchange” in Rule 3b-16 under the Exchange Act are not sufficiently circumscribed or defined and therefore potentially capture too many systems under the definition of “exchange,” as discussed below. We are particularly concerned that many buy-side systems that bear no resemblance to “exchanges” or ATSS will be captured by the proposed provisions. Consequently, we cannot support the proposed amendments to Rule 3b-16 as described in the Proposal, as we believe they will impair the ability of our members and other market participants to access the securities markets.

Furthermore, MFA believes that the proposed changes to the definition of “exchange” warrants a more thorough evaluation and that the Commission should use the comments it receives in connection with this Proposing Release to evaluate whether to return with a new proposal that sets forth a clearer set of regulatory goals and appropriately tailored measures, particularly in respect of the new concept of “communication protocol system” (“CPS”). However, if, despite the concerns we and other commenters present, the Commission determines to move forward with these amendments to the definition of “exchange,” we believe the proposal in respect of the definition of “exchange” should be significantly clarified and carefully circumscribed to ensure that the Commission does not unintentionally capture venues that do not warrant inclusion and create resultant consequences that harm market participants such as our members and the investors whose interests they seek to serve.

III. Proposed Amendments to Regulation ATS for Government Securities ATSS

The Commission proposes to update Regulation ATS by eliminating the exemption for Government Securities ATSS.⁶ The Commission proposes to require Government Securities ATSS to file Form ATS-N (as proposed to be revised), which would be subject to the Commission’s review and effectiveness process, and would require a Government Securities ATS to disclose information about its manner of operations and the ATS-related activities of the registered broker-dealer or government securities broker or government securities dealer that operates the ATS and its affiliates. The Commission is also proposing to apply Rule 301(b)(5) of Regulation ATS (the “**Fair Access Rule**”) to Government Securities ATSS that meet certain volume thresholds in U.S. Treasury Securities or in a debt security issued or guaranteed by a U.S. executive agency or government-sponsored enterprise (“**Agency Securities**”). The Proposal would also extend the requirements of Regulation SCI to Government Securities ATSS that meet certain average daily volume metrics.

⁵ See *id.* at 2, 6.

⁶ Government Securities ATSS are ATSS that limit their securities activities to government securities as defined under Section 3(a)(42) of the Exchange Act or repurchase and reverse repurchase agreements on government securities.

MFA continues to advocate for the thoughtful regulation of trading venues and to ensure these venues provide consistent and robust disclosure and transparency to investors about their operation. Importantly, we supported the Commission’s proposal to amend the regulatory requirements in Regulation ATS applicable to ATSs that transact in National Market System (“NMS”) stocks (“**Reg ATS Proposal**”).⁷ In our comments on the Reg ATS Proposal, we recommended that the framework set out for ATSs transacting in NMS stocks should be extended to include ATSs that trade fixed income securities, including government securities. As we have noted, ATSs that trade only government securities and register as broker-dealers or are banks are currently exempt from exchange registration and are not required to comply with Regulation ATS. Moreover, we noted that ATSs that trade both government securities and non-government debt securities such as corporate bonds are not subject to various provisions of Regulation ATS, such as the heightened disclosure and fair access requirements, and provisions of Regulation SCI.

A. Application of Regulation ATS Investor Protections

As noted in our 2021 Letter, the application of Regulation ATS to Government Securities ATSs would trigger certain requirements including, significantly, requiring the adoption of written safeguards and written procedures to protect confidential trading information and the separation of ATS functions from other broker-dealer functions, including principal and customer trading.⁸ MFA therefore supports this aspect of the Proposal to eliminate the exemption from Regulation ATS for Government Securities ATSs. The safeguarding of trading information is critical to MFA members. We believe requiring currently exempted Government Securities ATSs to operate under the requirements of Regulation ATS, including the requirement to adopt written safeguards and written procedures to protect subscribers’ confidential trading information and to separate ATS functions from other broker-dealer functions, can help protect the integrity of a subscriber’s confidential trading information that could otherwise be at risk of unauthorized disclosure and subject to potential misuse. Such safeguards and practices also can help prevent the sharing of confidential subscriber trading information by ATSs with other customers or having the operator of the ATS use the confidential trading information of other subscribers to advantage its own trading on the ATS.⁹

⁷ See Letter from Stuart J. Kaswell, Executive Vice President & Managing Director, General Counsel, Managed Funds Association and Jiri Krol, Deputy CEO, Global Head of Government Affairs, Alternative Investment Management Association to Brent J. Fields, Secretary, SEC on February 26, 2016 on Regulation of NMS Stock ATSs, available at: <https://www.managedfunds.org/letters/mfa-submits-joint-letter-to-sec-on-regulation-ats/> (“**Reg ATS Letter**”).

⁸ Other requirements include requiring such systems to permit the examination and inspection of its premises, systems, and records, and cooperate with the examination, inspection, or investigation of subscribers; making and keeping certain records and preserving records; and periodically reporting certain information about transactions on the ATS and information about certain activities on Form ATS-R within 30 calendar days after the end of each calendar quarter in which the market has operated.

⁹ We believe that other aspects of the new investor protection requirements on Government Securities ATSs also could prove beneficial to MFA members and other investors. For example, requiring currently exempted Government Securities ATSs to comply with the recordkeeping and reporting requirements of Regulation ATS and requiring such ATSs to file a confidential Form ATS-R with the Commission can improve the Commission’s ability

B. Application of the Fair Access Rule to Government Securities ATSS

The Fair Access Rule currently only applies to the trading of NMS stocks, equity securities that are not NMS stocks and for which transactions are reported to an SRO, municipal securities, and corporate debt securities, but not to trading in government securities. Therefore, currently there is no mechanism to prevent Government Securities ATSS from unreasonably denying or limiting subscribers' access to a trading venue that is a significant market for government securities.¹⁰ The Proposal would extend the Fair Access Rule to such securities.¹¹

MFA supports applying the Fair Access Rule to Government Securities ATSS. We agree with the Commission that the principles underlying the Fair Access Rule are equally relevant to a Government Securities ATS and that amending the Fair Access Rule to include the trading of U.S. Treasury Securities and Agency Securities would help ensure the fair treatment of potential and current subscribers to ATSS that transact in a large percentage of trading volume in these two types of securities. Extending the Fair Access Rule to Government Securities ATSS also can help prevent discriminatory actions that could hurt investors lacking access to an ATS by limiting trading venue options for these investors, potentially resulting in higher trading costs and the reduction in trading efficiency.

C. Proposed Form ATS-N for Government Securities ATSS

MFA supports a requirement that Government Securities ATSS file a publicly available form with the Commission that discloses important operational aspects of the ATS. To that end, we support the Commission's proposal to require Government Securities ATSS to file Form ATS-N with the Commission. However, as noted below, we do not support the proposed inclusion of communication protocol systems, as described in the Proposal, into the definition of "exchange" and therefore do not support the proposed amendments to Form ATS-N that flow from that aspect of the Proposal.

to monitor currently exempted Government Securities ATSS and improve its oversight of the market for government securities execution services overall.

¹⁰ An ATS subject to the Fair Access Rule under Regulation ATS must, among other things, establish written standards for granting access to trading on its systems and apply these standards fairly, and is prohibited from unreasonably prohibiting or limiting any person with respect to trading in a stated security when that trading exceeds certain volume thresholds.

¹¹ Specifically, under the proposed amendments, a Government Securities ATS would be subject to the Fair Access Rule if, during at least four of the preceding six calendar months, the Government Securities ATS had: (1) with respect to U.S. Treasury Securities, five percent or more of the average weekly dollar volume traded in the United States as provided by the self-regulatory organization to which such transactions are reported, and (2) with respect to Agency Securities, five percent or more of the average daily dollar volume traded in the United States as provided by the self-regulatory organization to which such transactions are reported.

D. Proposed Amendments to Regulation SCI for Government Securities ATSS

The Proposal would amend Regulation SCI to expand the definition of “SCI alternative trading system” to include Government Securities ATSS.¹² Under the Proposal, a Government Securities ATS that meets the proposed amended definition would fall within the definition of “SCI entity” and, as a result, would be subject to the requirements of Regulation SCI depending on hitting certain volume thresholds.¹³

MFA supports extending Regulation SCI to Government Securities ATSS as proposed. We agree with the Commission that, in light of the increasing automation of the government securities market and the operational similarities between many Government Securities ATSS and NMS Stock ATSS, it is appropriate to apply the requirements of Regulation SCI to Government Securities ATSS that have significant volume. We also agree that the proposed extension of Regulation SCI could help strengthen the infrastructure and improve the resiliency of the automated systems of Government Securities ATSS that are important to the government securities markets.¹⁴

While we recognize that many Government Securities ATSS may already have adopted system testing and control procedures similar to those required under Regulation SCI, we support putting a formalized regulatory framework in place through the expansion of Regulation SCI to ensure consistency of regulatory obligations and Commission oversight. As the resiliency of the markets is critical to MFA and its members, we believe that imposing the requirements of Regulation SCI on Government Securities ATSS meeting the volume thresholds will help reduce the potential for systems issues in the market for trading and execution services in government securities.

¹² A Government Securities ATS would have to meet certain volume thresholds, specifically that during at least four of the preceding six calendar months, the Government Securities ATS had: (1) with respect to U.S. Treasury securities, five percent or more of the average weekly dollar volume traded in the U.S. as provided by the SRO to which such transactions are reported or (2) with respect to Agency Securities, five percent or more of the average daily dollar volume traded in the U.S. as provided by the SRO to which such transactions are reported.

¹³ Regulation SCI requires SCI entities to establish, maintain and enforce written policies and procedures reasonably designed to ensure that their key automated systems have levels of capacity, integrity, resiliency, availability, and security adequate to maintain their operational capability and promote the maintenance of fair and orderly markets. Regulation SCI also requires SCI entities to take appropriate corrective action when systems issues occur; provide certain notifications and reports to the Commission regarding systems problems and systems changes; inform members and participants about systems issues; conduct business continuity and disaster recovery testing and penetration testing; conduct annual reviews of their automated systems; and make and keep certain books and records.

¹⁴ Specifically, extending Regulation SCI to Government Securities ATSS may reduce the frequency, severity, and duration of the effects of any systems issues, and the additional safeguards can reduce the potential for failures, disruptions, delays, and intrusions, which could place government securities market participants at risk, harm price discovery, and reduce price efficiency.

IV. Proposed Amendments to Exchange Act Rule 3b-16 Regarding the Definition of “Exchange” and Inclusion of Communication Protocol Systems

Although MFA strongly supports the Commission’s proposal to bring Government Securities ATSS within a similar regulatory regime to ATSS that trade NMS stocks, we are concerned about the Proposal’s other most significant component—a component that was not included in the 2020 Proposal and is therefore being subject to the public notice and comment process for the first time. Specifically, the Commission proposes a number of changes to the terms used in the definition of “exchange” in Exchange Act Rule 3b-16. Most prominently, the Commission has proposed to include “communication protocol systems” within the definition of “exchange.” In addition, the Commission proposes to replace the term bringing together “the orders for securities of multiple buyers and sellers” with bringing together “buyers and sellers of securities using trading interest” and, more generally, replacing the term “orders” with “trading interest” to expand the scope of the definition to include non-firm trading interest that does not meet the definition of “order.” Under the Proposal, “trading interest” would not only include an order, but “any non-firm indication of a willingness to buy or sell a security that identifies at least the security and either quantity, direction (buy or sell), or price.”¹⁵

We believe that each of these proposed changes requires significant clarification to ensure that there are no unintended consequences to its members and other market participants.

A. The Commission Should Either Reevaluate or Significantly Clarify the Proposed Amendments to Exchange Act Rule 3b-16

MFA believes that the Commission’s proposed changes to Rule 3b-16 represent a substantial step beyond the substance of the 2020 Proposal and could be taken to represent a significant reconceptualization of key features of the broader securities market’s structures to encompass entities and activities that have never been considered previously to be an “exchange” or a system appropriate for regulation under the Regulation ATS regime. Because of the significant impact this aspect of the Commission’s proposal could have on market structure, the Commission’s proposed amendments to Rule 3b-16 warrant a more thorough review by the Commission—similar to the process that the Commission has undertaken in similar circumstances, including the adoption of Regulation ATS—and MFA advocates for a re-proposal of this concept after the Commission has had an opportunity to review comments and, in particular, reassesses how best to approach the concept of including “communication protocol systems” within Rule 3b-16.

B. Communication Protocol Systems

MFA believes, absent significant clarification that limits its scope, the Commission’s proposal to add the term “communication protocol system” into Rule 3b-16 and to classify such

¹⁵ The Commission also proposes to include within the definition of “exchange” a system that “makes available” (rather than “uses”) established, non-discretionary methods under which “buyers and sellers” (rather than “orders”) can interact and agree to the terms of a trade.” These changes alone could have significant impact on the scope of systems that are deemed to be “exchanges.”

systems as “exchanges” under the Exchange Act would represent an expansive approach that stretches the normal meaning of “exchange.” This is particularly the case given the Commission’s statement that it would broadly interpret the phrase, and although the Proposal includes a number of examples of the types of systems that the Commission would consider to be *included* within the term, the Proposal is significantly less clear on the systems that the Commission would consider *not to be included*.

Although as described in our 2021 Letter, MFA supports consideration of extending the scope of Regulation ATS to certain types of additional platforms, such as RFQ venues, we believe that the potentially expansive language used to describe the Commission’s intent in bringing communication protocol systems within the definition of “exchange” is too broad in scope and is in conflict with the Commission’s economic analysis, which suggests a relatively small number of systems that would be captured by the proposed amendments. Given the breadth with which the Commission has described communication protocol systems—and the Commission’s statement that it intends to “take an expansive view of what would constitute ‘communication protocols’ under this prong of Rule 3b-16(a)”¹⁶—the number of systems the Commission estimates will be affected is potentially quite underinclusive.¹⁷ The estimates provided in the Commission’s economic analysis suggest an initial intent to capture relatively few systems; however, the lack of a definition for “communication protocol systems” and the examples used throughout the Proposal cast doubt on those estimates.

If the Commission moves forward with amendments to Rule 3b-16 that include this term, the Commission should provide clear guidance to market participants to help understand the term, for example through the provision of specific examples,¹⁸ defining the term “communication protocol system,” or adopting clear exemptions from the definition of “exchange.” Hand in hand with much clearer parameters should be a more carefully considered economic analysis of systems that will and will not be in scope. MFA believes rigorous economic analysis is critical for interested persons to assess the impact of the Proposal and for the Commission to make an informed decision about whether and how to proceed.

Should the Commission determine to move forward with the proposed amendments and include communication protocol systems within Rule 3b-16, MFA believes it is imperative that the Commission clarify which systems the Commission considers to be within the scope of the term “exchange” *and which systems are not within the scope*. In particular, we believe the following systems should be specifically excluded from the definition of “exchange”:

¹⁶ Proposing Release at 15507.

¹⁷ For example, the Commission estimates that there are only four Communication Protocol Systems operating in the market for NMS stocks that may meet the definition of exchange under the proposed changes to Exchange Act Rule 3b-16. *See* Proposing Release at 15613.

¹⁸ For example, the Commission provided numerous helpful examples of the types of systems it would consider to be included and excluded from the definition of “exchange” when it adopted Regulation ATS and Rule 3b-16. *See* Regulation of Exchanges and Alternative Trading Systems Exchange Act, 63 Fed. Reg. 70844, 70854-56 (Dec. 22, 1998), available at: <https://www.govinfo.gov/content/pkg/FR-1998-12-22/pdf/98-33299.pdf>.

- Order/Execution Management Systems. MFA does not believe that order/execution management systems used by a single entity to buy and sell securities are intended to be captured by the Proposal. As noted in the Proposal in respect of the current rule, “[t]he term ‘multiple’ was added to Rule 3b-16(a) to help reinforce that single counterparty systems were not included in the definition of ‘exchange.’”¹⁹ Despite proposing to remove the word “multiple” from the rule, the Proposal does not appear to be intended to change this approach; however, given the breadth with which communication protocol systems are described, the Commission should make its position on this issue clear. Clarification is essential to create regulatory certainty. Unless the order management system allows other persons to interact with each other, as opposed to with the entity operating the system, the system should not be covered by the new definition of exchange. Currently, traders do not look at their order management systems as exchanges even if they receive firm orders. Broadening the scope of the rule by replacing “orders” with “trading interest” should not affect the analysis.
- Single Firm Trading Interest Communication Systems. MFA understands that a number of its members operate systems designed to facilitate their trading. In some instances, these systems permit firms to contact one, or multiple, broker-dealers for potential trading interest. These firms may not be registered as “dealers” under the Exchange Act and thus may not be able to rely on the existing exception in Rule 3b-16(b) if the Commission replaces the term “order” with “trading interest.” In some instances, different buy-side firms may license or use the same system; however, the individual systems do not interact with one another. These systems may therefore have “multiple” buy-side firms using the same system (though not interacting). The Commission should clarify that systems used by individual firms to communicate with dealers to trade for themselves or on behalf of their clients are not “exchanges” under the Exchange Act.
- Order routing systems. Systems that are merely routing orders should not be considered exchanges. Although Rule 3b-16 already includes an exemption for certain order routing systems, the Commission should clarify that a firm’s internal systems and technologies for handling orders, trading interest and other information among its own (or its affiliates) limit order books are not considered “exchanges.”

Unless the Commission clearly indicates that it does not intend such systems to be deemed “exchanges” within the scope of the proposed definition, then MFA believes the Commission should perform a far more extensive and rigorous analysis of the attendant consequences and costs of such a policy decision than the Proposal currently presents.

¹⁹ Proposing Release at 15505.

C. Enhanced Disclosure on Form ATS-N

MFA supports certain of the disclosure enhancements to Form ATS-N as proposed by the Commission; however, as noted above, MFA does not support the expansion of Rule 3b-16 to “communication protocol systems” as described in the Proposal and therefore does not support the proposed amendments to Form ATS-N related to that expansion.

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We appreciate the opportunity to provide these comments on the proposed amendments and concept release. If you have any questions about these comments, or if we can provide further information, please do not hesitate to contact Matthew Daigler, Vice President & Senior Counsel, or the undersigned at (202) 730-2600.

Respectfully Submitted,

/s/ Jennifer W. Han

Jennifer W. Han
Executive Vice President
Chief Counsel & Head of Regulatory Affairs

cc: The Honorable Gary Gensler, Chair
The Honorable Allison Herren Lee, Commissioner
The Honorable Hester M. Peirce, Commissioner
The Honorable Caroline A. Crenshaw, Commissioner
Dr. Haoxiang Zhu, Director, Division of Trading and Markets